BANKRUPTCY POLICY AND THE DECISION OF THE HIGH COURT IN *PYRAMID BUILDING SOCIETY (IN LIQ) v TERRY*

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In *Pyramid Building Society (in liq) v Terry*,[1] the High Court held that a contingent creditor was not bound by the terms of a composition entered into pursuant to Part X of the *Bankruptcy Act 1966*. Accordingly the debtors (Mr and Mrs Terry), under this form of insolvency administration, were not able to make a fresh start upon entering the composition, released from their liabilities. Similarly creditors were not treated equally by the High Court decision — the unsecured creditors were bound by the Part X arrangement while the contingent creditor (the Building Society) was not. The purpose of this article is to examine this decision against the background of the insolvency legislation policy rationale.

INTRODUCTION

The decision of the High Court in *Pyramid Building Society (in liq) v Terry*[2] implicitly brings into focus one of the fundamental tensions in insolvency law. That is, to what extent should the fresh start policy — the idea that upon discharge from insolvency, the natural person has the opportunity to begin anew without the burden of the previous accumulated debt — be subjugated to what may be perceived to be the community or public interest in ensuring that the laws designed to assist the individual are not abused by high-profile bankrupts. Ultimately, the High Court was in favour of lenders. It was decided that contingent creditors were not bound by the composition as their debts were not provable — hence they could pursue those debts despite the insolvency administration. But at what expense to the tenet of the clean sheet for the debtor?[3]

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1 (1997) 189 CLR 176

2 Ibid.

3 Note the comments by M Gronow, Contingent Creditors and Part X Arrangements

The purpose of this article is to examine the case against this dichotomy of competing aims of insolvency — to provide the insolvent with a clean start but to enact laws which fairly represent the interests of creditors and of the wider community The first part of the article will consider the purposes of insolvency law, including an analysis of what is meant by a 'provable debt' and to examine how this accords with the history and objectives of insolvency The second part of the article will consider the facts and holding of the High Court decision and will conclude with a discussion as to whether the decision sits in accord with the stated purposes, history and aims of insolvency legislation.

THE PURPOSES OF INSOLVENCY LAW, PARTICULARLY IN TERMS OF THE MEANING OF 'PROVABLE DEBT'

Brief summary of the objectives of insolvency law

The Australian Law Reform Commission[4] considered that there were a number of principles that guided the development of modern insolvency law These were as follows:

- insolvency law is to provide a fair and orderly process for dealing with the financial affairs of insolvent individuals and companies;
- insolvency law should provide mechanisms that enable both the debtor and creditors to participate in the process;
- insolvency administrations should be impartial, efficient and expeditious;
- there should be a convenient means to collect and realise the property;
- *equality between creditors should be retained and enhanced,*
- *the end result of insolvency administration, particularly as it affects individuals, should, with very limited exceptions, be the effective relief or release from the financial liabilities and obligations of the insolvent,*
- *insolvency law should, support the commercial and economic processes of the community,*

(1996) 4 *Insolvency Law Journal* 139 139 in reference to the Victorian Court of Appeal decision in this case (a result reversed upon appeal to the High Court) that: The decisions are good news for guarantors, and bad news for lenders They mean that a guarantor with a small group of favourably disposed direct creditors can escape a large contingent liability under a guarantee notwithstanding opposition from the contingent creditor Given that the result was reversed by the High Court, lenders can now breathe more easily

4 Australian Law Reform Commission, *General Insolvency Inquiry*, vol 1, Report No 45 (1988).

- insolvency law should harmonise with the general law; and
- insolvency law should enable ancillary assistance in the administration of an insolvency originating in a foreign country[5] (emphasis added).

The principles italicised dominate current thinking As stated by Kirby J in *Pyramid Building Society (in liq) v Terry*:[6] 'Two features of [bankruptcy law] history are relevant The first is the gradual way by which all debts and liabilities came to be included in the bankruptcy The objective of legislation of this kind was, generally speaking, "*that all creditors should be entitled to come in and prove, and that the bankrupt should emerge from the bankruptcy freed from his liabilities*".'[7] (emphasis added)

The application of these two principles — that all creditors should be entitled to prove (and, I would add, prove equally) and that the bankrupt should be freed from his liabilities — can cause very significant difficulties, as the decision in *Pyramid Building Society (in liq) v Terry* demonstrates [8] The essence of this decision was that, on the facts, to treat contingent creditors in the same category as other unsecured creditors would have led to a severe injustice — a point recognised by Brooking JA in the Victorian Court of Appeal:[9]

> I suspect that most fair-minded business men and women would not think well of what the law has allowed to be accomplished in this case In present day Australia escape from bankruptcy by payment of a trivial sum to settle huge debts has been seen by some as a public scandal and a reproach to the bankruptcy laws In the present case the debtors, having $350 to their name and debts of the order of $1 5 million were able to procure the payment of $10 000 from some fund or other to their minor creditors and (by way of remuneration) those administering the composition As a result of this $10,000 payment they have destroyed the debt of their major creditor

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5 Ibid 15-17 See also the comments by R Tomasic and K Whitford, *Australian Insolvency and Bankruptcy Law* (2nd ed, 1987) 4-7

6 (1997) 189 CLR 176, 212.

7 Kirby J quoted from *Hardy v Fothergill* (1888) 13 App Cas 351, 364 See also the comments by D Rose, *Lewis Australian Bankruptcy Law* (10th ed, 1994) 1; S Dowling, Whether Penalty Tax on Unpaid Income Tax is a Provable Debt: The Decision in Re Vera Kavich (1995) 3 *Insolvency Law Journal* 208 209, referring to the Federal Court decision of *Re Vera Kavich* (Unreported, Federal Court of Australia 30 June 1995); A Keay *Insolvency — Personal and Corporate Law and Practice* (1993) 9; R B Vermeesch and K E Lindgren, *Business Law of Australia* (8th ed, 1995) 1194

8 It is also a problem in the tax area. See: S Dowling, Whether Penalty Tax on Unpaid Income Tax is a Provable Debt: The Decision in Re Vera Kavich (1995) 3 *Insolvency Law Journal* 208 For a discussion of the American position in respect of this tension between bankruptcy law and equality of creditors, see S H Nickles, Consider Process Before Substance, Commercial Law Consequences of the Bankruptcy System: Urging the Merger of the Article 9 Drafting Committee and the Bankruptcy Commission (1995) 69 *American Bankruptcy Law Journal* 589

9 *Something Better Pty Ltd v Pyramid Building Society (in liq)* [1996] 2 VR 352, 362

By the same token, to treat creditors differently can lead to erosion of the fresh start principle

What must be critically remembered in respect of bankruptcy policy is that, by necessity, it is a recognition that the current cash flow of the individual is insufficient to meet the current debts It is not necessarily a situation where the assets of the individual are exceeded by their liabilities As stated in *Sandell v Porter*:[10]

> [The] debtor's own moneys are not limited to his cash resources immediately available. They extend to moneys which he can procure by realisation by sale or by mortgage or pledge of his assets within a relatively short time — relative to the nature and amount of the debt and to the circumstances, including the nature of the business, of the debtor The conclusion of insolvency ought to be clear from a consideration of the debtor's financial position in its entirety and generally speaking ought not to be drawn simply from evidence of a temporary lack of liquidity It is the debtor's inability, utilising such cash resources as he has or can command through the use of his assets to meet his debts as they fall due which indicates insolvency.

The response of the law to this situation has changed dramatically over the years [11] Early Greek and Roman remedies allowed for the body of an individual to be pledged as a slave to pay off his or her debts,[12] with the English permitting the imprisonment of the individual by the end of the 13th century.[13] The law of insolvency was seen to have a punishment role — that the community and society would be best served by adopting a rule that would have as its central tenet, deterrence for others, punishment of the individual. The malicious harshness of the time can be recognised in the following:[14]

> If one be in execution he ought to live of his own, and neither the plaintiff nor the sheriff is bound to give him meat or drink, no more than if one distrains cattle and puts them in a pound for there the owner of the cattle ought to give them meat, and not he that distrained them, no more is the party or the sheriff, who has one in execution, bound to give meat to the prisoner, but he ought to live of his own goods — and if he has no goods, he shall live of the charity of others and if others will give him nothing, let him die in the name of God, if he will and impute the cause of it to his own fault, for his presumption and ill behaviour brought him to that imprisonment

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10 *Sandell v Porter* (1966) 115 CLR 666, 670 See also: *Rees v Bank of New South Wales* (1964) 111 CLR 210, 218, 229-30; *Hymix Concrete Pty Ltd v Garrity* (1977) 13 ALR 321, 328.

11 For a discussion of the historical antecedents of the present legislation, see I Duffy English Bankrupts, 1571-1861' (1980) 24 *The American Journal of Legal History* 283

12 See also: W Holdsworth, *A History of English Law* (4th ed, 1927) vol 8 230.

13 *Statute of Marlborough 1267*, c 23; 25 Edw III c 17

14 *Dive v Manningham* (1551) 1 Plowden 60, 68; 75 ER 96 108-9

The first English legislation to deal with bankruptcy and to make provision for distribution amongst all creditors was the Act of 1542: *An Act against such persons as do make Bankrupt* [15] This Act provided for a body of commissioners to take control of the debtor's property and to recover property fraudulently transferred The property was distributed pro-rata The debtor was not released from the unpaid debts

The 1571 legislation[16] built upon this Act by providing more extensive powers of investigation and the acquisition of after acquired property The law was limited to traders.

> The act does not explain why bankruptcy was confined to traders However, parliament clearly accepted contemporary allegations of widespread mercantile misconduct which according to the preambles of two Jacobean bankruptcy statues had been detrimental not only to trade itself, but also to the country at large and the many clothiers who employed a large portion of the workforce [17]

Importantly, this legislation reflected the idea that people should not be released from their debts, but that whatever property was available should become payable and distributable pro-rata amongst creditors. Essentially, the law still saw the debtor as responsible for his or her obligations, but with the realisation that greater community benefit would flow from pro-rata distribution as against individual creditors pursuing their own remedy

Bankruptcy legislation was extended in England in the 17th century with the Acts of 1604,[18] 1623[19] and 1662.[20] These Acts, whilst still confined to traders, were notable for the introduction of the penalty of pillory stock imprisonment Debtors found guilty of improper conduct were attached to the pillory by one ear That ear was left remaining when the debtor was released

The legislation was again amended in the 18th century,[21] and reflected, one suspects, a softening of community attitude,[22]

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15 34 & 35 Hen VIII, c 4.

16 *The Act of Elizabeth*, 13 Eliz I, c 7 See also: *The Act Touching Orders for Bankrupts* 34 & 35 Hen VIII, c 4

17 I Duffy, 'English Bankrupts, 1571–1861 (1980) 24 *The American Journal of Legal History* 283 284.

18 1 Jac I c 15.

19 21 Jac I, c 19

20 13 & 14 Car II, c 24

21 *Bankruptcy Act 1705*, 4 Anne, c 17; and *1732*, 5 Geo II, c 30

22 As stated by I Duffy, English Bankrupts, 1571–1861 (1980) 24 *The American Journal of Legal History* 283 286–7: These were adopted because of the conviction, previously hinted at in the 1624 act, that a law which was 'all Penalty and no Reward" was self-defeating; by compelling bankrupts to relinquish all property to some creditors and then exposing them to perpetual imprisonment by others, it encouraged evasion even by traders who would otherwise be willing to cooperate

whereby the debtor was released from his or her debts Blackstone noted:[23]

> If by accidental calamities, as by the loss of a ship in a tempest, the failure of brother traders, or by the non-payment of persons out of trade, a merchant or trader becomes incapable of discharging his own debts it is his misfortune and not his fault

This amelioration of the legislation in the attitude to debtors was reflected more strongly in the 18th century legislation The legislation[24] extended the law to all persons and set up a Court of Bankruptcy Importantly, the debtor was also permitted to file a declaration of insolvency, and arrangements outside of bankruptcy were permitted [25]

Ultimately, a consolidated *Bankruptcy Act* was passed in 1914[26] which formed the basis of the first Australian Federal legislation, the *Bankruptcy Act* of 1924. This Act was repealed and replaced by the present legislation, the Commonwealth *Bankruptcy Act 1966*.

As shown by this summary, the legislative history of bankruptcy has seen a move away from the idea that the bankrupt was a criminal and deserving of punishment to a theme that where the bankrupt has not been guilty of dishonesty, that person should be able to make a fresh start — a journey from the idea that insolvency is an individual problem to a reflection that for the benefit of the community as a whole, less harsh legislation is appropriate [27]

> The soul of debtor financial relief, the fresh start, is found in the availability of a discharge and in the protection of exempt property Together these attributes can be viewed as a unified system whose focus is on the debtor and his future as a living, breathing person Debtor financial relief should be considered a separate and distinct policy objective of Congress which should not be intertwined with the policies relating to the creditor-orientated debt collection and distribution

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23 William Blackstone, *Commentaries on the Laws of England* (18th ed, 1829) vol 2 (with the last corrections of the author, and copious notes by J E Hovenden) 474 Contrast the comment by Lord Kenyon in 1798: Bankruptcy is considered as a crime and bankrupt in the old laws is called an offender.' *Fowler v Padget* (1798) 7 Term Rep 509; 101 ER 1103, 1103

24 For example, 1 & 2 Wm IV, c 56; 5 & 6 Vict c 116, 12 & 13 Vict, c 106, 24 & 25 Vict c 134, 32 & 33 Vict, c 71 and 46 & 47 Vict c 52.

25 D Rose *Lewis Australian Bankruptcy Law* (10th ed 1994) 15 comments that the change in the legislation was attributable to the humanitarian views of the late 18th century led by the Benthamite school of reformers

26 4 & 5 Geo V, c 59

27 Interestingly, some of the amendments in recent years, such as the *Law and Justice Legislation Amendment Act 1990* and the *Bankruptcy Amendment Act 1991* have imposed more onerous requirements on bankrupts In many respects these amendments, which introduced concepts such as the Income Contribution Scheme (Division 4B of Part VI) the restrictions on overseas travel (Division 4C of Part VI) and the recovery of property from associated entities (Division 4A of Part VI), reflected abuse of the legislation by certain individuals.

> function of the law Debtor financial relief is an ethical and moral response to the inevitable inability to pay debt Such a response stands as a beacon in a long history of Anglo-American responses to debtor financial default which has ranged from death to imprisonment [28]

The question that needs to be addressed in any discussion of insolvency policy is: what is the policy behind the provision of a clean slate to the debtor — why is the debtor permitted to make that fresh start?

> What is the central justification for financial rehabilitation of the consumer debtor? The answer to this question goes to the very heart of our present consumer bankruptcy process For without a central understanding of why the process exists, it is not logically possible to evaluate whether the goals obtained by the implementation of that policy through legislation are justified [29]

These competing ideals of a fresh start and creditors ranking equally caused a division of opinion amongst the judiciary[30] in *Pyramid Building Society (in liq) v Terry* When undertaking an examination of this case it must be borne in mind that the facts of the High Court decision concerned a Part X arrangement under the *Bankruptcy Act 1966*, this being a composition However this is not to deny the fundamental tenet that the purpose and aim of Part X of the *Bankruptcy Act 1966*, as with insolvency law generally,[31] is to ensure a fresh start and to see that creditors rank equally Whilst it can be appreciated that Part X arrangements offer advantages such as the avoidance of the stigma of bankruptcy, the avoidance of the personal inconveniences of bankruptcy, and a faster and less costly process for creditors,[32] the objective is still, as Kirby J appreciated in *Permanent Building Society (in liq) v Terry*, that:[33]

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28 R E Flint, 'Bankruptcy Policy: Toward a Moral Justification for Financial Rehabilitation of the Consumer Debtor' (1991) 48 *Washington and Lee Law Review* 515, 529.

29 Ibid 518

30 The trial judge favoured the Building Society: *Pyramid Building Society (in liq) v Something Better Pty Ltd* (Unreported, Supreme Court of Victoria Hayne J 8 September 1994); the three judges of the Court of Appeal favoured the Terry's: *Something Better Pty Ltd v Pyramid Building Society (in liq)* [1996] 2 VR 352; whereas the High Court was split 3:2 in favour of the Building Society In essence, globally, five judges favoured the Terry s, four favoured the Building Society

31 It should be noted that the Australian Law Reform Commission, *General Insolvency Inquiry*, vol 1 Report No 45 (1988) when discussing insolvency principles at 15–17, commented in reference to insolvency law generally

32 See the discussion in D Rose, *Lewis Australian Bankruptcy Law* (10th ed, 1994) 248–9.

33 (1997) 189 CLR 176, 212 In support of this, His Honour referred to *Flint v Barnard* (1888) 22 QBD 90, 92–4; and *Report of the Committee Appointed to Review the Bankruptcy Law of the Commonwealth* (1962) paras 291–5, 337

> *all* creditors should be entitled to come in and prove, and that the bankrupt should emerge from the bankruptcy freed from all his liabilities. The same general objectives apply to a composition under Pt X.

Given these twin objectives of insolvency law, how has the definition of a 'provable debt' adapted to meet these societal aims? It is an issue to which I will now turn [34]

The history of the law relating to what is a 'provable debt' in an insolvency administration

The earliest insolvency legislation did not define what was meant by 'a debt'[35] Perhaps in response to this, the courts narrowly defined what constituted a 'provable debt' The debt had to be a liquidated sum and could not be subject to any contingency [36]

This was altered in 1721 and subsequently in 1809 by legislation [37] These acts permitted the proof of debt so that a debt due at the date of bankruptcy but not payable until some later date could be proved. These amendments were held not to assist the contingent creditor [38]

From this position gradual relief was provided to the contingent creditor[39] whereby the categories of debts that could be proved in an insolvency became more numerous, leading ultimately to the provisions of the current s 82 of the *Bankruptcy Act 1966* Section 82(1) reads as follows (and without modification for how it reads in relation to Part X arrangements):

> Subject to this division, all debts and liabilities, present or future, certain or contingent, to which a bankrupt was subject at the date of the bankruptcy, or to which he may become subject before his discharge by reason of an obligation incurred before the date of the bankruptcy are provable in the bankruptcy

Subsection 82(8) provides (again without modification for how it reads when applied to Part X arrangements):

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34 This history is outlined by Brooking JA in the Court of Appeal decision *Something Better Pty Ltd v Pyramid Building Society (in liq)* [1996] 2 VR 352, 353–5. The summary is taken principally from this judgment

35 34 & 35 Hen VIII, c 4 1542; 13 Eliz, c 7 1570

36 *Re Browne & Wingrove; Ex parte Ador* [1891] 2 QB 574, 579; *Trustees Executors and Agency Co Ltd v Cowan* (1906) SASR 155 174; *Tully v Sparkes* (1728) 2 Stra 867; 92 ER 903

37 7 Geo I, c 31 1721; 49 Geo III c 121 1809

38 See the authorities cited by Brooking JA in *Something Better Pty Ltd v Pyramid Building Society (in liq)* [1996] 2 VR 352, 354

39 Eg: 19 Geo II, c 32; 6 Geo IV, c 16; *Bankrupt Law Consolidation Act 1849* (12 & 13 Vict, c 106); *Bankruptcy Act 1861* (24 & 25 Vict c 134); *Bankruptcy Act 1869* (32 & 33 Vict, c 71)

In this section liability includes:

(a) compensation for work or labour done;

(b) an obligation or possible obligation to pay money or money's worth on the breach of an express or implied covenant contract agreement or undertaking, whether or not the breach occurs is likely to occur or is capable of occurring, before the discharge of the bankruptcy; and

(c) an express or implied engagement, agreement or undertaking, to pay, or capable of resulting in the payment of, money or money's worth whether the payment is:

(i) in respect of amount — fixed or unliquidated;

(ii) in respect of time — present or future or certain or dependent on a contingency; or

(iii) in respect of the manner of valuation — capable of being ascertained by fixed rules or only as matter of opinion.

The result of this legislative development was conveniently summarised by Tadgell JA in *Something Better Pty Ltd v Pyramid Building Society (in liq)*:

> Mellish LJ in *Re Hide; Ex parte Ilynvi Coal and Iron Co* (1871) LR 7 Ch App 28 at 33, referring to the 1869 Act, regarded it as quite plain that the object of these sections is that the bankrupt shall be absolutely relieved from any liability under any contract he has ever entered into Section 82, in unmodified form, is to be given a similarly wide signification with a view to providing for the result that the bankrupt is to be a freed man — freed not only from debts, but from contracts liabilities, engagements and contingencies of every kind [40]

Pyramid Building Society (in liq) v Terry: Facts and Decision

Mr and Mrs Terry were the directors, along with one Hegarty, of a property development company called Something Better Pty Ltd. The company sought finance to develop a shop and office complex with monies raised from the Pyramid Building Society. The Society lent the company an amount in excess of three million dollars. First mortgage security was taken over the site. In addition, Mr and Mrs Terry were guarantors of this debt. When default was made, the property was realised leaving Mr and Mrs Terry liable under the guarantee for an amount slightly in excess of $1.3M.

The Arguments

Mr and Mrs Terry argued that they were not liable on the guarantee as they had, prior to default by the company, entered into a composition

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40 [1996] 2 VR 352, 370

under Part X of the *Bankruptcy Act 1966* which released them from liability for any provable debts. Under the composition, the creditors accepted in full settlement the sum of $10 000, subject to the costs of administration. Mr Terry disclosed assets of $200 with debts of $101 575 whereas Mrs Terry disclosed assets of $150 against unsecured debts of $61 575.[41] The argument by Mr and Mrs Terry was that, at the time of entering into the composition, s 240[42] of the *Bankruptcy Act 1966* operated to release them from all provable debts. The guarantee to the Pyramid Building Society was a contingent debt (contingent upon the failure of the company to meet the loan obligations); all debts, contingent or otherwise, were provable; and thus the debtor was released from any obligation pursuant to the provisions of the legislation.

The Building Society argued that the amendments to s 82 which modified its operation led to the result that contingent debts were not released upon the entering into of a composition.

This argument found favour with the trial judge[43] and by a 3:2 majority in the High Court.[44] The Full Court of Victoria preferred the argument of Mr and Mrs Terry.[45]

The decision

The decision of the High Court was that a contingent debt was not a provable debt for the purposes of a composition. Accordingly Mr and Mrs Terry still had an obligation to pay — an obligation which could not be submersed behind a composition.

Behind the technical arguments on the wording of the legislation (an aspect which will be discussed shortly) lies the policy debate. Should Mr and Mrs Terry, upon entering into an insolvency administration, be entitled to a fresh start, free from the strictures of a $1.3M debt, and should all creditors, be they contingent or otherwise, be treated equally? Has the ultimate finding of the High Court led to a weakening of the idea of a clean slate for the debtor, or was this a particular finding on the

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41 As stated by Brooking JA in *Something Better Pty Ltd v Pyramid Building Society (in liq)* [1996] 2 VR 352, 353, 'although the debtors dwelt in Moule Avenue, Brighton the assets of the wife might have been exhausted by filling to the brim a supermarket trolley'.

42 Section 240(1) provides: Subject to this section, a composition under this Part operates, unless set aside, declared void or terminated under this Part, to release the debtor from all provable debts, other than those (if any) that would not be released by his discharge from bankruptcy if he had become a bankrupt on the day on which the composition was accepted.

43 *Pyramid Building Society v Something Better Pty Ltd* (Unreported, Supreme Court of Victoria, Hayne J, 8 September 1994).

44 (1997) 189 CLR 176.

45 *Something Better Pty Ltd v Pyramid Building Society (in liq)* [1996] 2 VR 352.

facts, a decision which accords with community expectation? Given this scenario, how does one balance the community expectation of a fair and just insolvency system with the underlying rationale and axiomatic principle that the debtor is entitled to a fresh start?

The joint judgment of Gaudron and Gummow JJ

Their Honours proceeded upon a statutory analysis of the provisions Section 240 of the *Bankruptcy Act 1966* provided for a release upon entering into a composition for all provable debts. Section 82, in its unmodified form, provided that all debts, including contingent debts, were provable. However for the purposes of a composition, r 84 of the *Bankruptcy Rules 1968* (Cth) indicated that s 82 was to be amended as noted below (the parts deleted from the original s 82 are struck through):

> 82(1) Subject to this Division, all debts and liabilities present or future, certain or contingent, to which a bankrupt was subject at the date of the bankruptcy or to which he may become subject before his discharge by reason of an obligation incurred before the date of the bankruptcy, are provable in his bankruptcy

Subsection 82(8) is modified as follows:

> In this section, liability includes:
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> (a) compensation for work or labour done; and
>
> (b) ~~an obligation or possible obligation to pay money or money's worth on the breach of an express or implied covenant, contract, agreement or undertaking, whether or not the breach occurs, is likely to occur or is capable of occurring, before the discharge of the bankruptcy;~~
>
> ~~(c)~~ (b) an express or implied engagement agreement or undertaking, to pay or capable of resulting in the payment of, money or money's worth, whether the payment is:
>
> (i) in respect of amount — fixed or unliquidated; or
>
> (ii) ~~in respect of time — present or future, or certain or dependent on a contingency; or~~ in respect of the manner of valuation — capable of being ascertained by fixed rules or only as matter of opinion

The submission of the appellant Pyramid Building Society (a submission ultimately accepted by Gaudron and Gummow JJ) was that the term 'debt', when not expanded by phrases such as 'certain or contingent' and 'present or future', identified an obligation actually incurred, rather than one yet to be fulfilled.[46] Further, the legislative history of the term 'debt' indicated that until the legislation specifically included the phrase 'contingent', these sorts of debts were not provable [47]

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46 *Pyramid Building Society (in liq) v Terry* (1997) 189 CLR 176, 188–9

47 Ibid

McHugh J

His Honour agreed with their Honours Gaudron and Gummow JJ that the appeal should be allowed, but with one important qualification He was unable to agree with their conclusion that, read literally, s 82(1) as modified did not cover a liability under a guarantee of the kind entered into by Mr and Mrs Terry [48] McHugh J considered that the provision had to be considered in light of its history and purpose

> When the history of the section and the purpose of the modifications enacted by r 84 are examined, the best conclusion that can be drawn from the statutory scheme is that liabilities of the kind in question in this case remain on foot after a debtor makes a composition with his or her creditors [49]

Kirby J (in dissent) (with whom Toohey J agreed) [50]

Kirby J summarised what he considered as his role in the following statement:

> Like the long history of bankruptcy legislation to which this Court was taken a study of the changes effected in legislative provisions over time may help to explain the purpose of the particular change in question But it is the legislation which must be given effect The Court's duty is to ascertain the purpose of the Parliament as expressed in the language it has used No attempt to give effect to an inferred purpose authorises a court to neglect the Act's language [51]

Kirby J considered that the appellant's case was extremely arguable[52] and importantly, that justice and business efficacy supported its case [53]

> Nevertheless, for reasons grounded in the language of the Act as well as in its history and apparent policy, I do not consider that the apparent injustice in this case is one which this court can cure To do so would not be to adopt a purposive approach which I would always be foremost to favour It would be to strain the language of the Act already modified by the operation of a rule whose purpose is obscure and whose effect is limited [54]

His Honour then proceeded to counter the arguments put forward by the majority judges First, even allowing for the alteration to s 82 brought about by r 84, the language of the section still permitted contingent debts to be included in the category of provable debts [55] Secondly, even

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48 Ibid 194.
49 Ibid
50 Ibid 181.
51 Ibid 206.
52 Ibid 210.
53 Ibid 210.
54 Ibid
55 In particular, his Honour referred (at 210–11) to sub-ss 82(4)–(6) which refer to debts subject to a contingency and a provision for their valuation

as modified, s 82(8) refers to a 'liability' and this phrase should be given the meaning that it would ordinarily bear.[56] Additional points were that that the history and purpose of insolvency legislation was that all creditors should rank equally and that the insolvent should be freed from all his liabilities.[57] Accordingly, contingent creditors were within the category of provable debts for a composition. Finally his Honour considered that to conclude that contingent debts were not provable for the purposes of a Part X arrangement would lead to a significant element of instability in the Act and in the certainty and finality of compositions.[58]

Kirby J concluded:[59]

> The proper answer to the appellant's complaint about injustice lies not in a distortion of more than a century of bankruptcy law. Still less does it reside in the performance of major surgery on the language of the Act which the rule-maker with explicit power to modify it held back from attempting. If there was an injustice in the composition agreed by the respondents' creditors with present and certain debts and liabilities the remedy for a contingent creditor such as the appellant was to apply to the Federal Court to set the composition aside. It was not to press this Court to adopt an interpretation which the statutory language properly analysed will not bear.

CONCLUSION

There is no doubt that the aims of insolvency law are to permit the debtor to obtain a fresh start, yet to treat all creditors equally. Similarly the laws must be seen to harmonise with the legitimate expectations of the wider community. Indeed many reforms in recent years have sought to reconfigure that balance so that abuse by high profile entrepreneurs is discontinued.[60] Nevertheless the underlying feature of the bankruptcy law is the discharge — the idea that the debtor can begin again on the economic treadmill — 'to earn, consume and borrow'.[61] It is recognised as a feature of insolvency wherever the purposes and objectives on bankruptcy are discussed.[62]

In that sense, has the majority view ignored this principle by providing that in a composition, contingent creditors occupy a privileged position? If this is accepted, the judgment of Kirby J (with

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56 Ibid 211-12.
57 Ibid.
58 Ibid 213.
59 Ibid 214.
60 See the comments at note 27.
61 R E Flint, 'Bankruptcy Policy: Toward a Moral Justification for Financial Rehabilitation of the Consumer Debtor' (1991) 48 *Washington and Lee Law Review* 515, 516.
62 See the list of authorities at note 7.

whom Toohey J agreed) is to be preferred. Ultimately the decision must be one of legislative policy. Should the fresh start principle have been eroded? Should all creditors, including contingent creditors, be treated equally? The High Court, by a majority, indicated that Mr and Mrs Terry were not entitled to have a clean slate and that certain creditors were in a privileged position. In any consideration of the law the judiciary must articulate the policies applicable to the interpretation of the provision, for only then can the true value of precedent be seen. If the community demands a different interpretation because of changing societal conditions, then the interpretation of the law can be fairly and justly altered. But in the case of *Permanent Building Society (in liq) v Terry*, where we have five judges in favour of Mr and Mrs Terry and four supporting the Building Society, it is difficult to see the decision as establishing a principle with significant precedent value. One suspects it is a matter that will be reappraised.[63]

63 It should be noted that since this decision the *Bankruptcy Act 1966* has been amended so that if a debtor's Part X proposal is approved by creditors, the debtor will obtain a release of all provable debts, including contingent debts, upon her or his release from bankruptcy. See the comment by I Greenall 'Alternatives to Bankruptcy for Debtors' (1999) 8 *New Directions in Bankruptcy* 25, 26.